

Letter of Findings: 04-20120616
Gross Retail Tax
For the Years 2009, 2010, and 2011

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ISSUE

I. Bad Debt Deduction – Gross Retail Tax.

Authority: IC § 6-2.5-6-9; IC § 4-22-7; IC § 6-8.1-3-3(b)(2); IC § 6-8.1-3-4; [45 IAC 15-9-2](#)(d); Chrysler Financial Co., LLC v. Indiana Dept. of Revenue, 761 N.E.2d 909 (Ind. Tax Ct. 2002); Sales Tax Information Bulletin 28S (April 2012); I.R.C. § 166(a)(1).

Taxpayer argues that the Department erred when it disallowed a bad debt deduction claimed on its ST-103 sales tax returns.

STATEMENT OF FACTS

Taxpayer is an Indiana business which operates a "buy-here-pay-here" automobile dealership. The Department of Revenue ("Department") conducted an audit review of Taxpayer's business records and concluded that Taxpayer owed additional sales tax. Taxpayer disagreed with that decision and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Letter of Findings results.

I. Bad Debt Deduction – Gross Retail Tax.

DISCUSSION

The Department's audit report explains that Taxpayer sold most of its automobiles by means of "buy-here-pay-here" agreements. As explained in the report, "The customer makes a down payment and signs a financing contract with the [T]axpayer agreeing to make set weekly or monthly payments." Taxpayer does not operate a separate financing entity. The customer agreements are neither sold nor transferred.

Taxpayer operates its accounting system on an accrual basis. When an automobile is sold, the sale is "booked," and sales tax is reported and remitted.

The audit found that Taxpayer was deducting on its monthly sales tax return a line-item amount intended to recover sales tax paid on vehicles that Taxpayer either repossessed or in instances in which the customer surrendered the car.

The Department found Taxpayer's method of claiming a line-item deduction on the ST-103 flawed citing to Sales Tax Information Bulletin 28S (April 2012), 20120530 Ind. Reg. 045120259NRA, which states that:

If a transaction results in an abandoned vehicle, there may be a bad debt deduction for federal tax purposes that could lead to the retail merchant or other legally entitled party having a bad debt deduction available for sales tax purposes, as provided in [IC 6-2.5-6-9](#). The retail merchant or other legally entitled party may claim any available sales tax bad debt deduction by filing a claim for refund on Form GA-110L.

If a transaction results in a repossessed vehicle, there may be a bad debt deduction for federal tax purposes that could lead to the retail merchant or other legally entitled party having a bad debt deduction available for sales tax purposes, as provided in [IC 6-2.5-6-9](#). The retail merchant or other legally entitled party may claim any available sales tax bad debt deduction by filing a claim for refund on Form GA-110L. (Emphasis added).

Taxpayer objects citing to IC § 6-2.5-6-9 which states in part:

(a) In determining the amount of state gross retail and use taxes which a retail merchant must remit under section 7 of this chapter, the retail merchant shall, subject to subsections (c) and (d), deduct from the retail merchant's gross retail income from retail transactions made during a particular reporting period, an amount equal to the retail merchant's receivables which:

- (1) resulted from retail transactions in which the retail merchant did not collect the state gross retail or use tax from the purchaser;
- (2) resulted from retail transactions on which the retail merchant has previously paid the state gross retail or use tax liability to the department; and
- (3) were written off as an uncollectible debt for federal tax purposes under Section 166 of the Internal Revenue Code during the particular reporting period.

(b) If a retail merchant deducts a receivable under subsection (a) and subsequently collects all or part of that receivable, then the retail merchant shall, subject to subsection (d)(6), include the amount collected as part of the retail merchant's gross retail income from retail transactions for the particular reporting period in which the retail merchant makes the collection.

....

(d) The following provisions apply to a deduction for a receivable treated as uncollectible debt under

subsection (a):

(1) The deduction does not include interest.

(2) The amount of the deduction shall be determined in the manner provided by Section 166 of the Internal Revenue Code for bad debts but shall be adjusted to exclude: (A) financing charges or interest; (B) sales or use taxes charged on the purchase price; (C) uncollectible amounts on property that remain in the possession of the seller until the full purchase price is paid; (D) expenses incurred in attempting to collect any debt; and (E) repossessed property.

(3) The deduction shall be claimed on the return for the period during which the receivable is written off as uncollectible in the claimant's books and records and is eligible to be deducted for federal income tax purposes. For purposes of this subdivision, a claimant who is not required to file federal income tax returns may deduct an uncollectible receivable on a return filed for the period in which the receivable is written off as uncollectible in the claimant's books and records and would be eligible for a bad debt deduction for federal income tax purposes if the claimant were required to file a federal income tax return. (Emphasis added).

In summary, IC § 6-2.5-6-9 provides that when a taxpayer has remitted sales tax on a sale for which the taxpayer has not collected the sales tax and has written the amount off as a bad debt under Section 166 of the Internal Revenue Code, the taxpayer may report a sales tax bad debt deduction. The amount of the sales tax bad debt deduction is based upon the deduction provided in Section 166 of the Internal Revenue Code for uncollectible bad debts with certain adjustments excluding amounts relating to interest, charges for financing, charges for sales or use tax, property remaining in the possession of the seller, collection expenses, and repossessed property.

Taxpayer is cautioned that the bad debt deduction must be taken on the return for the period when the bad debt was eligible to be written off under Section 166 of the Internal Revenue Code.

As provided above, the amount of the sales tax bad debt deduction is based upon the deduction provided in I.R.C. § 166 for uncollectible bad debts with a few adjustments. I.R.C. § 166(a)(1) provides that a taxpayer may take "a deduction for any debt which becomes worthless within the taxable year."

Taxpayer argues that the Indiana statute mandates that a bad debt allowance be reflected on the Taxpayer's monthly sales tax returns. As Taxpayer explains, the bad debt allowance "is to be claimed on the return for the period in which the bad debt was incurred." Taxpayer maintains that to the extent that Sales Tax Information Bulletin 28S requires the filing of a refund claim by means of a GA-110L, the Bulletin "is in violation of the statute and without authority" and that "to the extent that the Bulletin is relied on to force taxpayers to file refund claims, it is illegal."

Taxpayer is correct to the extent that IC § 6-2.5-6-9 does allow Taxpayer to claim a legitimate "bad debt" deduction on the sales tax return at the time in which the bad debt was incurred. Nonetheless, the Taxpayer is reminded of the concurrent requirements set out in [45 IAC 15-9-2\(d\)](#). That provision provides specific criteria necessary to obtain a refund. The regulation states:

(d) When filing a claim for refund with the department the taxpayer's claim shall set forth:

(1) the amount of refund claimed;

(2) a sufficiently detailed explanation of the basis of the claim such that the department may determine its correctness;

(3) the tax period for which the overpayment is claimed; and

(4) the year and date the overpayment was made.

The claim for refund shall be filed on a form prescribed by the department.

In order to obtain a refund, the claim must set out the amount requested, an explanation detailing the basis for the claim, and provide the time period during which the overpayment was made. In addition, the regulation states that the claim be made on the form required by the Department. See also IC § 6-8.1-3-4 ("The department has the sole authority to furnish forms used in the administration and collection of the listed taxes, including reporting of information in an electronic format.")

Taxpayer is effectively requesting the refund of a substantial amount of sales tax. Taxpayer is correct when it points out that IC § 6-2.5-6-9 permits Taxpayer to claim the deduction on the sales tax return "for the period during which the receivable [was] written off as uncollectible...." Nonetheless, Taxpayer is reminded that it must provide – or be prepared to provide – the specific information set out in [45 IAC 15-9-2\(d\)](#).

Generally, taxpayers write off bad debts on an annual basis and file sales tax returns on a monthly or quarterly basis. Additionally, entities, which do not file sales tax returns and have purchased installment contracts from retail merchants, are allowed to claim refunds based upon a bad debt deduction. See generally *Chrysler Financial Co., LLC v. Indiana Dept. of Revenue*, 761 N.E.2d 909 (Ind. Tax Ct. 2002). To accommodate taxpayers in these situations and to address administrative concerns, the Department requires that the affected taxpayers obtain the refund by filing a GA-110L.

Sales Tax Information Bulletin 28S, requiring the preparation and submission of the GA-110L, was published in the Indiana Register. As of the publication of that Information Bulletin, the Department fulfilled its obligation under IC § 6-8.1-3-3(b)(2) to give notice of its "change of interpretation" concerning the method by which certain

taxpayers may obtain a refund of sales tax on the basis of a "bad debt." IC § 4-22-7 permits the Department to adopt regulations or to promulgate an "interpretation" in the Indiana Register as long as that "interpretation" does not increase the taxpayer's liability. Although Taxpayer's protest is sustained, the Department may require the filing of a GA-110L by taxpayers that do not file sales tax returns and by taxpayers that do not write off bad debts for the same periods in which they are reporting their sales tax.

FINDING

Taxpayer's protest is sustained.

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